NOTE: This transcript of the Secretary's notes is not to be regarded as complete or necessarily entirely accurate. The transcript is for the sole use of the members of the Federal Advisory Council. The concise official minutes for the entire year are printed and distributed later.

H.V.P.
W.J.K.

The Secretary's notes of the meeting of the Federal Advisory Council on May 15, 1967 at 9:30 A.M. in the Board Room of The Madison, Washington, D.C. All members of the Federal Advisory Council were present except Henry T. Bodman. Mr. Herbert V. Prochnow, President of The First National Bank of Chicago, attended as an Alternate for Mr. Bodman.

The Council approved the Secretary's notes for the meeting of February 20-21, 1967.

ITEM I A, B AND C

ECONOMIC CONDITIONS AND PROSPECTS.

A. HOW DOES THE COUNCIL APPRAISE THE GENERAL ECONOMIC OUTLOOK THROUGH THE END OF 1967?

B. TO WHAT EXTENT HAS CONSTRUCTION ACTIVITY RECOVERED IN THE COUNCIL MEMBERS' RESPECTIVE REGIONS, AND WHAT ARE THE PROSPECTS FOR CONSTRUCTION OVER THE REST OF THE YEAR?

C. WHAT IMPRESSIONS DO COUNCIL MEMBERS HAVE FROM THEIR CUSTOMER CONTACTS OF THE PROBABLE VOLUME OF NEW CORPORATE BOND ISSUES OVER COMING MONTHS?

President Moorhead read Item I in its entirety and invited members of the Council to recite on their respective districts.

Although several members cited evidence of uncertainty on the part of consumers and businessmen, the general conclusion was that business and economic activity will continue to rise moderately through the end of 1967. This will reflect in large measure the anticipated increase in government expenditures, particularly as a result of military operations in Vietnam. A number of members indicated that they thought that the inventory adjustment is not completed and that they also doubted that capital spending would expand importantly. It was concluded, however, that these developments would be obscured by the continued rise in government expenditures and in consumer outlays, especially for services. The recovery in construction activity varied from district to district and by type of construction. Most members, however, anticipate some further increase in building activity over the rest of the year.

A discussion of the corporate bond market disclosed the expectation of a continuation of the present large volume over the coming months. Several members expressed doubt, however, that the current volume of corporate bond borrowing will be sustained during the year.

ITEM II A

BANKING DEVELOPMENTS.

A. WHAT IS THE COUNCIL'S ASSESSMENT OF THE STRENGTH OF BUSINESS LOAN DEMAND CURRENTLY AND OVER THE NEXT FEW MONTHS?

President Moorhead read Item II A. The discussion disclosed a somewhat uneven pattern of loan demand both within districts and between institutions. It was reported that some banks were in a relatively comfortable position compared with last fall, whereas loan totals at other institutions were at or near all-time highs. It was reported that most bankers are experiencing a fairly strong underlying demand which they anticipate will be sustained over the next few months.

ITEM II B

B. HOW WOULD COUNCIL MEMBERS APPRAISE RECENT AND PROSPECTIVE CHANGES IN DEMAND FOR CONSUMER C/D'S? IN DEMAND FOR SAVINGS DEPOSITS? IN RATES PAID ON TIME AND SAVINGS DEPOSITS?

President Moorhead then read Item II B. The members of the Council reported a strong and persistent demand for consumer C/D's which they expect to continue. Conversely, the higher rate for consumer C/D's has tended to make passbook savings somewhat less attractive although in recent weeks these balances have shown a tendency to increase. The recent decline in short-term interest rates has put downward pressure on the consumer C/D rate structure. It was concluded that as a consequence, the 5 per cent interest rate on consumer C/D's is considerably less secure today than it was a few months ago. Offsetting this pressure, however, is the competitive situation with other local savings institutions.

ITEM II C

C. DO COUNCIL MEMBERS EXPECT ANY SIGNIFICANT CHANGES IN BANK LENDING POLICIES IN THE NEAR FUTURE?

President Moorhead read Item II C. While acknowledging that many bankers are selectively more receptive to loan requests than they were a short time ago, there was little expectation of any significant change in bank lending policies in the near future.

ITEM II D

D. WHAT ARE THE PRESENT ATTITUDES OF BANKS WITH RESPECT TO THE ADEQUACY OF THEIR LIQUIDITY POSITIONS?

The President then read Item II D. A brief discussion followed in which it was concluded that there are some bankers who would like to rebuild further their liquidity positions which were substantially reduced during the period of stringent credit last summer.

ITEM II E

E. WHAT ARE THE PRESENT ATTITUDES OF BANKS WITH RESPECT TO THE ADEQUACY OF THEIR CAPITAL POSITIONS? WITH RESPECT TO THE RELATIVE USEFULNESS OF (1) INCREASED CAPITAL, AND (2) REALIGNMENT OF ASSETS, AS MEANS OF IMPROVING CAPITAL POSITIONS? WITH RESPECT TO THE PROBABLE MARKET RECEPTION OF FLOTATIONS OF BANK CAPITAL?

President Moorhead read Item II E. The Council observed that many bankers are not satisfied with their capital positions. It was noted also that in general bankers would prefer to increase their capital rather than attempt to realign assets as a means of improving capital positions. Several members pointed out that the borrowing requirements of their customers seriously limit the ability of banks freely to realign their assets which thus lessens the usefulness of this technique as a method for improving capital positions.

After some discussion about the probable market reception of flotations of bank capital, the Council concluded that the absence currently of new issues in the market suggests that bankers are doubtful about their market reception unless they are priced at levels unacceptable to the banks.

ITEM II F

F. WHAT ARE THE VIEWS OF BANKS AS TO THE RECENT EXPANSIONS OF BANK CREDIT CARDS AND THE METHODS FOLLOWED IN THOSE EXPANSIONS? AS TO THE PROBABLE FUTURE OF BANK CREDIT CARDS IN THE FINANCIAL PICTURE?

The President then read Item II F. A brief discussion on bank credit cards followed. It was concluded that they are a useful technique, in that over time they should tend to channel into banks a growing share of consumer instalment credit now provided by many retail establishments. Several members of the Council acknowledged, however, that the initial promotion by some banks overemphasized the importance of bank credit cards in relation to the over-all activities of the bank. The Council also concluded that bank credit cards are a logical development toward the retail marketing of bank services in the future. It was emphasized, however, that banks wishing to offer this service should be urged to analyze critically markets, costs, losses and other aspects of their procedure.

ITEM III A AND B

BALANCE OF PAYMENTS.

A. DO COUNCIL MEMBERS EXPECT FOREIGN DEMANDS FOR TERM LOANS, SHORT-TERM LOANS, AND ACCEPTANCE CREDITS FROM U. S. BANKS TO CHANGE SIGNIFICANTLY IN THE MONTHS AHEAD?

B. WOULD THE COUNCIL EXPECT U. S. BANK INDEBTEDNESS TO THE EURO-DOLLAR MARKET TO INCREASE, DECLINE, OR REMAIN ABOUT UNCHANGED IN THE NEXT FEW MONTHS?

The President of the Council read Item III A and B. A brief discussion followed. It was concluded that foreign demands for term loans may increase because of the substantial need for longer-term credit. The demand for short-term loans and acceptance credits from U. S. banks are likely to remain about the same in the months ahead because of the somewhat slower pace of economic activity that marks the economies of many of the trading nations of the world. The Council also concluded that it was not possible to have a meaningful judgment on the volume of U. S. bank indebtedness to the Euro-dollar market in the next few months. Instead, the Council decided to note that the volume will be largely determined by the availability of funds in our markets and the competitiveness of interest rates here and abroad.

ITEM IV

WHAT ARE THE COUNCIL'S VIEWS ON MONETARY AND CREDIT POLICY UNDER CURRENT CIRCUMSTANCES?

President Moorhead read Item IV and invited comment from the Council. An extended discussion followed. The Council concluded that it should acknowledge to the Board its awareness of the difficult dilemma the Board faces as it attempts to formulate an appropriate credit policy in view of the uncertainty of the outlook for business and the following conflicting objectives:

1) providing the reserves required to insure the financing of the federal budget deficit, while at the same time

2) combating the inflationary pressures a large deficit may precipitate.

The Council then concluded that it would reaffirm its views on credit policy as expressed in its February Confidential Memorandum to the Board. The statement follows:

> "The Council in general approves of the easing that characterizes current monetary and credit policy. Moreover, the Council is hopeful of favorable consideration by the Congress of a more restrictive fiscal policy--a reduction in nondefense expenditures, or failing that, an increase in taxes. This will permit a more balanced mix of fiscal and monetary policy rather than the undue reliance on credit restriction which marked much of 1966.
>
> "Because of the balance of payments and inflationary problems, any further significant easing of monetary policy should be contingent upon a more balanced mix of fiscal and monetary policy or a further slowing in overall business activity."

The meeting adjourned at 12:35 P.M.

THE COUNCIL CONVENED IN THE BOARD ROOM OF THE FEDERAL RESERVE BUILDING, WASHINGTON, D.C., AT 2:30 P.M. ON MAY 15, 1967. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT HENRY T. BODMAN.

The members of the Board's staff, including Messrs. Daniel H. Brill, Senior Adviser to the Board; Robert C. Holland and Robert Solomon, Advisers to the Board, participated in a presentation on current business and economic developments.

THE COUNCIL RECONVENED AT 5:30 P.M. ON MAY 15, 1967, IN THE BOARD ROOM OF THE MADISON. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT HENRY T. BODMAN. MR. HERBERT V. PROCHNOW, PRESIDENT OF THE FIRST NATIONAL BANK OF CHICAGO, ATTENDED AS AN ALTERNATE FOR MR. BODMAN.

The Council prepared and approved the attached Confidential Memorandum to be sent to the Board of Governors relative to the Agenda for the joint meeting of the Council and the Board on May 16, 1967. The Memorandum was delivered to the Federal Reserve Building at 8 P.M.

The meeting adjourned at 7:10 P.M.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS
FROM THE
FEDERAL ADVISORY COUNCIL
RELATIVE TO THE AGENDA FOR THE JOINT MEETING
ON MAY 16, 1967

1. Economic conditions and prospects.

A. How does the Council appraise the general economic outlook through the end of 1967?

Despite some evidence of uncertainty on the part of consumers and businessmen, the Council expects that general business and economic activity will continue to rise moderately through the end of 1967. This will reflect in large measure the anticipated increase in Government expenditures, particularly as a result of military operations in Vietnam. Most members of the Council believe that the inventory adjustment is not completed, and that an important expansion in capital spending is somewhat in doubt. These developments, however, are likely to be obscured by the continued rise in Government expenditures and in consumer outlays, especially for services.

B. To what extent has construction activity recovered in the Council members' respective regions, and what are the prospects for construction over the rest of the year?

Although the recovery in construction activity varies somewhat from district to district and by the type of construction, most members anticipate some further increase in building activity over the rest of the year.

C. What impressions do Council members have from their customer contacts of the probable volume of new corporate bond issues over coming months?

The members of the Council expect a continued large volume of new corporate bond issues over the coming months. However, it is doubtful that the unprecedented current volume of new corporate bond borrowing will be sustained throughout the year.

2. Banking developments.

A. What is the Council's assessment of the strength of business loan demand currently and over the next few months?

Business loan demand since the year-end has been somewhat uneven, both within districts and institutions. Some banks report a relatively comfortable position, compared with last fall, whereas other institutions report loans at or near all-time highs. Most bankers are experiencing a fairly strong underlying demand which they anticipate will be sustained over the next few months.

B. How would Council members appraise recent and prospective changes in demand for consumer CD's? In demand for savings deposits? In rates paid on time and savings deposits?

The members of the Council find a strong and persistent demand for consumer CD's which they expect to continue. The higher rate for consumer CD's has tended to make passbook savings somewhat less attractive, although in recent weeks passbook savings have shown a tendency to increase. The recent decline in short-term interest rates is beginning to put some downward pressure on the consumer CD rate structure. As a consequence, the 5 per cent interest rate on consumer CD's is considerably less secure today than it was a few months ago. Offsetting this pressure, however, is the competitive situation with other local savings institutions.

C. Do Council members expect any significant changes in bank lending policies in the near future?

The members of the Council do not expect any significant change in banking lending policies in the near future. However, many bankers are selectively more receptive to loan requests than they were a short time ago.

D. What are the present attitudes of banks with respect to the adequacy of their liquidity positions?

Some bankers would like to rebuild further their liquidity positions which were substantially reduced during the period of stringent credit last summer.

E. What are the present attitudes of banks with respect to the adequacy of their capital positions? With respect to the relative usefulness of (1) increased capital, and (2) realignment of assets, as means of improving capital positions? With respect to the probable market reception of flotations of bank capital?

The members of the Council believe that many bankers are not satisfied with respect to the adequacy of their capital positions.

The Council is of the opinion that bankers would prefer to increase their capital rather than attempt to realign assets as a means of improving capital positions. The borrowing requirements of their customers seriously limit the ability of banks freely to realign their assets which thus lessens the usefulness of this technique as a method for improving capital positions. The absence currently of new bank capital flotations in the market suggests that bankers are doubtful of the market reception of such issues unless they are priced at a level unacceptable to the banks.

F. What are the views of banks as to the recent expansions of bank credit cards and the methods followed in those expansions? As to the probable future of bank credit cards in the financial picture?

Bank credit cards are a useful technique in that over a period of time they should tend to channel into banks a growing share of consumer instalment credit now provided by many retail establishments. But the initial promotion of credit cards by some banks has over-emphasized the importance of this service in relation to the overall activities of the bank.

The bank credit card is a logical development toward the retail marketing of bank services in the future. However, it is necessary for banks wishing to offer this service to analyze critically markets, costs, losses, and every aspect of their procedure.

3. Balance of payments

A. Do Council members expect foreign demands for term loans, short-term loans, and acceptance credits from U.S. banks to change significantly in the months ahead?

The Council members expect that foreign demands for term loans may increase because of the substantial need for longer term credit. The demand for short-term loans and acceptance credits from U.S. banks will remain about the same in the months ahead because of the somewhat slower pace of economic activity that marks the economies of many of the major trading nations of the world.

B. Would the Council expect U.S. bank indebtedness to the Euro-dollar market to increase, decline, or remain about unchanged in the next few months?

The Council expects that the volume of U.S. bank indebtedness to the Euro-dollar market will be largely determined by the availability of funds in our markets and the competitiveness of interest rates here and abroad.

4. What are the Council's views of monetary and credit policy under current circumstances?

The Council is aware of the difficult dilemma facing the Board as it attempts to formulate an appropriate credit policy in view of the uncertainty of the outlook of business and the following conflicting objectives:

(1) providing the reserves required to insure the financing of the Federal budget deficit, while at the same time

(2) combating the inflationary pressures a large deficit may precipitate.

In general, the Council reaffirms its views on this subject as expressed as follows in the Confidential Memorandum to the Board at the February meeting.

> The Council in general approves of the easing that characterizes current monetary and credit policy. Moreover, the Council is hopeful of favorable consideration by the Congress of a more restrictive fiscal policy--a reduction in nondefense expenditures, or failing that, an increase in taxes. This will permit a more balanced mix of fiscal and monetary policy rather than the undue reliance on credit restriction which marked much of 1966.
>
> Because of the balance of payments and inflationary problems, any further significant easing of monetary policy should be contingent upon a more balanced mix of fiscal and monetary policy or a further slowing in overall business activity.

ON MAY 16, 1967, AT 10:30 A.M., THE FEDERAL ADVISORY COUNCIL HELD A JOINT MEETING WITH THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM IN THE FEDERAL RESERVE BUILDING, WASHINGTON, D.C. ALL MEMBERS OF THE COUNCIL WERE PRESENT EXCEPT MESSRS. R. E. MC NEILL AND HENRY T. BODMAN. MR. HERBERT V. PROCHNOW, PRESIDENT OF THE FIRST NATIONAL BANK OF CHICAGO, ATTENDED AS AN ALTERNATE FOR MR. BODMAN.

THE FOLLOWING MEMBERS OF THE BOARD OF GOVERNORS WERE PRESENT: VICE CHAIRMAN ROBERTSON, GOVERNORS MITCHELL, DAANE, MAISEL, BRIMMER AND SHERRILL. MR. SHERMAN, SECRETARY, AND MR. KENYON, ASSISTANT SECRETARY, OF THE BOARD OF GOVERNORS, ALSO WERE PRESENT.

The minutes of the joint meeting are being prepared in the office of the Secretary of the Board of Governors of the Federal Reserve System. Their content will be compared with the notes of the Secretary of the Council. Assuming they are in substantial agreement, they will be reproduced and distributed to the members of the Council.

The meeting adjourned at 12:20 P.M.

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The next meeting of the Council will be held on September 18-19, 1967.

A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in the Board Room of the Federal Reserve Building in Washington, D. C., at 10:30 a.m. on Tuesday, May 16, 1967.

PRESENT: Mr. Robertson, Vice Chairman
Mr. Mitchell
Mr. Daane
Mr. Maisel
Mr. Brimmer
Mr. Sherrill

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary

Messrs. Simmen, Still, Mayer, Wilkinson, Fleming, Brinkley, Moorhead, Knight, Stewart, and Larkin, Members of the Federal Advisory Council from the First, Third, Fourth, Fifth, Sixth, Eighth, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively.

Mr. Prochnow, Secretary of the Council
Mr. Korsvik, Assistant Secretary of the Council

Vice Chairman Robertson conveyed to the Council Chairman Martin's regrets at being unable to attend today's meeting, noting that the Chairman's absence was occasioned by his acceptance of an invitation of long standing to make an address in connection with the 175th anniversary celebration of the New York Stock Exchange.

Governor Brimmer noted that he would unfortunately have to leave today's meeting within a few minutes in order to keep another engagement, as he had explained to members of the Council.

Governor Daane said that he would have to withdraw before the conclusion of the meeting because his role as a U.S. participant in the discussions relating to international monetary reform required him to leave for a meeting in Paris.

President Moorhead commented that in the absence of Mr. Bodman, member of the Council from the Seventh District, who was unable to attend this meeting of the Council, the District was being represented by Mr. Prochnow. He also noted that Mr. McNeill, member of the Council from the Second District, had found it necessary to return to New York following yesterday's meeting of the Council.

1. Economic conditions and prospects.

A. How does the Council appraise the general economic outlook through the end of 1967?

Despite some evidence of uncertainty on the part of consumers and businessmen, the Council expects that general business and economic activity will continue to rise moderately through the end of 1967. This will reflect in large measure the anticipated increase in Government expenditures, particularly as a result of military operations in Vietnam. Most members of the Council believe that the inventory adjustment is not completed, and that an important expansion in capital spending is somewhat in doubt. These developments, however, are likely to be obscured by the continued rise in Government expenditures and in consumer outlays, especially for services.

President Moorhead said the general feeling of the Council members was that the second half, and fourth quarter, of 1967 might be less exuberant than many were predicting. Nevertheless, the Council foresaw a continuing moderate rise in business and economic activity, particularly in view of prospective Government expenditures. In all the circumstances, the Council members did not see how the economy could do other than move upward, although perhaps not as rapidly as predicted by the Council of Economic Advisers and others.

Governor Mitchell asked whether the Council's forecast might imply a fourth-quarter GNP increase in the neighborhood of $12 billion, and President Moorhead replied that the Council had not tried to attach any numbers to its forecast. He added that there was some variation in the views of the members. He felt personally that the economic outlook through the end of 1967 was stronger than indicated by the Council's statement, which reflected the consensus of the group.

Governor Maisel inquired about the Council's views with respect to expenditures for plant and equipment, and President Moorhead replied that the Council, as its statement suggested, foresaw quite a moderate increase, realizing that that would mean moving upward from a rather high base.

Mr. Mayer noted that some sectors should be stimulated by the restoration of the investment tax credit. For example, the railroads should step up their purchases of freight cars. Where less sophisticated items were involved, the reaction to the restoration of the credit was likely to be quite prompt.

Governor Sherrill asked why the Council, as indicated in response to a subsequent question, foresaw a continued large volume of new corporate bond issues, and President Moorhead observed that to some extent the proceeds of the issues were being used to repay bank loans and to replenish corporate liquidity. Also, it was felt that there was a good deal of anticipatory borrowing. Corporations were coming to market now when they knew they could get the money. While rates were fairly high, the corporations had gotten more or less accustomed to them. For such reasons the Council felt that the calendar of new issues would continue strong, although not as large as in the first half of this year. The Council did not believe that the issues would necessarily be offered primarily to finance new plant and equipment expenditures.

Mr. Mayer commented that in many cases, as in the steel industry, corporations were paying now for expansion programs already put in process.

Mr. Larkin noted that a year ago, with bond yields rising, many corporations relied on the banks more than normally, in the hope that by waiting they would be able to finance at lower rates in the capital market. However, the situation turned in the other direction. Corporations became overextended, and they were now just catching up. This suggested to him that the pace of corporate offerings might slow down a bit later this year.

Governor Brimmer commented that the Board's staff had been trying to pin down the uses of the proceeds of corporate issues. From available evidence, the bulk of the proceeds seemed to have been used basically to restore liquidity, to pay taxes, and to pay for the continuing high level of plant and equipment expenditures. Until very recently there was little evidence of a substantial use of the proceeds of such issues to repay bank loans.

The staff, Governor Brimmer said, also had been endeavoring to keep up to date on the relationships between plant, equipment, and inventory expenditures and internally generated funds. In 1965 nonfinancial corporations had an excess of such expenditures over internally generated funds of around $8 billion, but in the final three quarters of 1966 the excess was around $16 billion, seasonally adjusted annual rate. Estimates for the first quarter of 1967 suggested that total investment exceeded internally generated funds by about $13 billion, seasonally adjusted annual rate.

President Moorhead commented that it was rather perplexing that, despite all the borrowing that had been done through the capital market, business loans had not been declining. Another Council member suggested that as the year went on bank loans might be repaid to a greater extent out of corporate issues.

Governor Brimmer withdrew from the meeting at this point.

Governor Daane inquired whether the Council foresaw a tapering off in the volume of corporate issues or a real cut-back, and President Moorhead replied that the Council members had tossed around some figures yesterday, one guess being a volume of perhaps $8 billion in the second half as compared with $12 billion in the first half.

Mr. Larkin noted that one factor would be the rate level. Corporate treasurers--and management--had now become accustomed to paying somewhat higher rates, but a movement of rates beyond 6 per cent might have an adverse psychological impact.

Governor Mitchell inquired whether the Council was suggesting that there would not be any appreciable inflationary expansion in 1967. A quarterly growth of GNP in the area of $10 million probably could be accommodated without too much difficulty, and he judged that the Council's economic forecast did not call for much more than that. He added that it would seem hard to argue for much restraint through fiscal policy if that was as far as the forecast went.

President Moorhead said his concern centered on the inflationary possibilities of the projected large Federal deficit. How that translated into terms of GNP, he was not sure.

Governor Mitchell said he had judged from the Council's statement that perhaps the Council looked for enough dampening of growth in the private sector so that Government expenditures would do no more than keep the economy moving at a sustainable pace.

President Moorhead agreed that the statement could be so interpreted. As he had said, however, he expected personally that the economy would be stronger.

Mr. Fleming said it was his feeling that the business outlook through the end of 1967 and the prospective budget deficit, taken in combination, created a base for inflationary tendencies.

Governor Daane observed that the Council did not foresee as much exuberance in the fourth quarter as some forecasters. Thus, the Council apparently was saying that inflationary pressures were more likely to occur after the end of the current year.

President Moorhead replied that the Council saw such pressures building up but did not look for any explosion until after the first of next year.

> B. To what extent has construction activity recovered in the Council members' respective regions, and what are the prospects for construction over the rest of the year?

> Although the recovery in construction activity varies somewhat from district to district and by the type of construction, most members anticipate some further increase in building activity over the rest of the year.

President Moorhead noted that there was now an entirely different atmosphere in the residential construction industry, with ample funds available. Nevertheless, there was bound to be quite a lag before major builders got large projects under way. Therefore, although the Council foresaw some further increase in building activity over the rest of the year, the members did not believe such activity would be as strong as some forecasters had predicted.

Governor Maisel commented that he was still looking for reasons to change the original forecast of 1.5 million housing starts for the year as a whole, but that thus far he had found no strong reasons for changing one way or the other.

President Moorhead said no Council member had reported anything phenomenal at yesterday's meeting. While building activity was gathering momentum, considerable lead time apparently would be required.

Mr. Fleming agreed. He added, however, that many believed that toward the end of the year homebuilding activity would be pushing forward rapidly.

Mr. Larkin said his comments on the Twelfth District at the previous Board-Council meeting still held true to a large extent. Things were on the way in the District, and it was simply a matter of time before actions now being taken resulted in houses that needed to be financed for the ultimate purchaser. The movement might be progressing somewhat more slowly than in the country as a whole, due to the overbuilding that had occurred earlier.

Mr. Mayer noted that in his area nonresidential construction was up quite a bit, largely by reason of commercial construction. President Moorhead added that in nearly all areas nonresidential construction seemed quite strong.

C. What impressions do Council members have from their customer contacts of the probable volume of new corporate bond issues over coming months?

The members of the Council expect a continued large volume of new corporate bond issues over the coming months. However, it is doubtful that the unprecedented current volume of new corporate bond borrowing will be sustained throughout the year.

Governor Mitchell asked whether banks were still encouraging customers to go to the public market, and Mr. Mayer replied in the affirmative. The banks, he said, wanted to begin the next round of loan expansion from a much lower base than at present.

Mr. Fleming observed that many business customers still using the banks heavily would have to go to the bond market at some point. The major question in their minds was whether they could obtain money at lower rates at some future date. Mr. Wilkinson commented that this was particularly true in the case of utilities. Mr. Fleming added that earlier this year banks had told a lot of customers that they thought money might be obtained at somewhat cheaper rates later on, but now the banks were beginning to doubt whether that was correct.

Mr. Larkin remarked that the foregoing observations applied to smaller as well as larger companies. Numerous defense-oriented companies that had been growing consistently and relying on bank financing would be forced to go to the public market. Mr. Mayer added that they would have to do so for their own sake if for no other reason. Mr. Simmen brought out, however, that many small companies, in New England at least, were not in a position to go to the bond market. Their only recourse was to seek bank financing if they wanted to expand.

Governor Mitchell inquired whether Mr. Mayer felt there were still quite a few borrowers that should cut down on their use of bank credit lines, and Mr. Mayer replied that the interpretation was a bit too narrow. He had simply meant to say that some companies were still relying a little too heavily on the banks for their financial requirements.

Governor Mitchell then referred to Mr. Mayer's comment that the banks would like to have a lower base from which to operate. He asked whether that comment suggested the nature of Mr. Mayer's expectations for the remainder of 1967 and for 1968.

Mr. Mayer replied in the affirmative. His remarks, he said, implied that the economy was going to continue to grow and reflected his concern as to whether banking facilities would grow fast enough to take care of customers whose financing needs were growing at a substantial rate. In many industries the addition of facilities was now much more expensive than formerly, and this trend was almost certain to continue as facilities became more and more sophisticated.

Mr. Fleming said that the experience of 1966 was still clearly in the minds of most bankers. They did not want to take a chance on being caught in the same kind of squeeze. Mr. Stewart observed that the question of asset mix was also involved.

Governor Mitchell mentioned that the banks had let the negotiable CD rate get down to around 4 per cent for a while, and members of the Council referred to the recent upward trend in rates offered on such instruments. Governor Mitchell asked whether the banks represented would issue 180-day certificates at 4-1/2 per cent readily, and several Council members replied in the affirmative.

President Moorhead noted that, as previously mentioned, it was of some interest that although a lot of the proceeds of corporate bond issues had been used to pay off bank debt, business loans continued to rise.

Governor Daane commented, in this connection, that the reported figures did not show that the proceeds of bond issues had been used to any major extent to repay bank loans. While one got the impression from conversations that a significant portion of the total proceeds had been used for such purpose, that did not show up in the figures, although perhaps there had been some change very recently.

Mr. Fleming said that not many bankers wanted to make term loans based on CD's, at least to the same degree as formerly. Although banks had to take care of the needs of their customers, they were not anxious to go out and solicit term loans on that basis.

Governor Mitchell noted that the savings and loan associations were experiencing such a large inflow of funds that they apparently did not know what to do with the money, and he observed that the banks also had been experiencing a good inflow of time money.

Mr. Fleming replied that until very recently the banks had not been enjoying any appreciable growth in passbook savings. Thus, President Moorhead pointed out, the principal growth had been in consumer-type CD's, about which the banks were still somewhat nervous. Mr. Mayer remarked that when other costs were added to a 5 per cent rate on CD's there was little margin left for profit. Mr. Prochnow mentioned that many large corporations were at present unwilling to give the banks CD money for more than 30 days. President Moorhead commented that, as Mr. Mayer had noted earlier, the economy was simply growing faster than the ability of the banks to finance it despite the inflow of time money.

Governor Mitchell observed that the banks had improved their share of the market in the 1960's. If they were going to hold that share, they evidently would have to be more aggressive on the time deposit side, for they were not going to hold it on the strength of demand deposits.

Mr. Fleming agreed and pointed out that until recently there had been a falling off in passbook savings. In the State of Tennessee the situation was particularly acute because, not being allowed to pay more than 4 per cent, banks were out of the market for CD's, with the result that the banking system was not growing very much. Any significant increase in the funds available to the banking system had to come through time certificates and CD's, and to a lot of bankers those funds represented hot money. Therefore, the banks could not grow on a secure basis. Bankers would prefer to see the growth occur in passbook savings, since they believed they would be able to depend on such funds better through the years. However, the banks were not now competitive in terms of passbook savings. With a 1/2 point spread, they could hold their own with the thrift institutions; if the spread became larger, money would flow to the mutual savings banks and the savings and loans.

Mr. Mayer pointed out that the banks had not had a good opportunity to judge the loyalty of consumer CD's. If more of those CD's had reached maturity during the period of greatest credit stringency last year, the banks might not have done as well as they did in retaining funds.

There followed a question about the size distribution of CD's, and Governor Sherrill said an FDIC survey last year revealed that 22 per cent of all CD's were in the amount of $10,000. Mr. Fleming noted the situation may have changed since the increase of deposit insurance to $15,000.

Governor Sherrill then referred to the guess, mentioned earlier by President Moorhead, that corporate bond offerings in the second half of this year might run around $8 billion as compared with $12 billion in the first half. He inquired whether that forecast was based principally on views with respect to rates or whether it suggested a saturation of demand.

President Moorhead replied that he thought both factors were involved. The Federal Government obviously would be in the market for substantial amounts of money, and rates might well rise on that account. And, as Mr. Larkin had said, there might be some psychological block if rates reached 6 per cent. Also, the unprecedentedly large volume of offerings in the first half simply did not appear sustainable over a period of time.

2. Banking developments.

A. What is the Council's assessment of the strength of business loan demand currently and over the next few months?

Business loan demand since the year-end has been somewhat uneven, both within districts and institutions. Some banks report a relatively comfortable position, compared with last fall, whereas other institutions report loans at or near all-time highs. Most bankers are experiencing a fairly strong underlying demand which they anticipate will be sustained over the next few months.

President Moorhead said there were considerable differences in the views of the Council members, depending on each member's own experience and the situation in his area. However, the general feeling was that a good deal of demand would appear if the banks were to let down the bars on certain types of loans.

Asked whether the differences were geographical or whether they reflected the policies of individual institutions, President Moorhead said he thought the geographical variations probably were less pronounced. Mr. Still said he was not sure. In the Philadelphia area loans were very high at most banks despite differing management philosophies. Mr. Wilkinson reported that although banks in the Fifth District were presently much easier than in December, a replacement was found each time a customer paid out. President Moorhead expressed the view that something depended on the size of the bank. In the Ninth District the smaller banks were approaching the city banks to purchase loans, while the city banks were experiencing a strong demand.

Mr. Prochnow said his bank's loans were running around 73 per cent of deposits and for a time last week it appeared that a situation comparable to that of last fall had developed. Loan demand was heavy across the board for reasons that were not too well defined. Mr. Still remarked that loan demand at his bank had started to pick up again last month, while Mr. Simmen commented that some banks in his area were now exceeding the peaks reached last July.

Mr. Still also pointed out that there had been a basic change in the composition of loan demand. Not too many short-term seasonal loans were made any more; the demand was much more steady and persistent. There were no longer the seasonal clean-ups of years past.

Governor Mitchell inquired whether any of the banks represented on the Council had their officers out seeking loans, and Mr. Wilkinson said his bank was doing that on a selective basis. It was trying to attract some people of good credit standing who were not taken on as customers last year. Mr. Knight said that every bank with which he was familiar in the Tenth District was now much more comfortable. It seemed that the District tended always to be behind the parade, attitudes perhaps being more cautious and conservative.

B. How would Council members appraise recent and prospective changes in demand for consumer CD's? In demand for savings deposits? In rates paid on time and savings deposits?

The members of the Council find a strong and persistent demand for consumer CD's which they expect to continue. The higher rate for consumer CD's has tended to make passbook savings somewhat less attractive, although in recent weeks passbook savings have shown a tendency to increase. The recent decline in short-term interest rates is beginning to put some downward pressure on the consumer CD rate structure. As a consequence, the 5 per cent interest rate on consumer CD's is considerably less secure today than it was a few months ago. Offsetting this pressure, however, is the competitive situation with other local savings institutions.

President Moorhead commented that, although consumer CD rates had been reduced in many instances, the Council believed the vast majority of banks were still at 5 per cent, due mainly to competitive pressures. The banks had experienced what they considered a healthy growth in consumer CD's, and they wanted to maintain a competitive position. Accordingly, they were reluctant to be the first to pull back on rates. If the savings and loan associations initiated such a move--and there was some evidence that they would--the banks probably would also begin to reduce their rates rather rapidly. His own bank had been picking up new customers through the consumer CD route that it hoped would stay with the bank. Accordingly, it would be rather slow to change the rates offered.

Governor Maisel inquired of President Moorhead whether the latter felt that consumer CD's were worth an extra 1/2 per cent compared with negotiable CD's, and the latter replied in the affirmative, saying that he believed the consumer CD's were likely to stay with the bank longer. Asked by Governor Mitchell whether the consumer CD's were worth 3/4 per cent more than passbook savings, President Moorhead replied in the negative. He pointed out, however, that the banks were restricted ratewise in the passbook area.

Governor Mitchell observed that Chairman Horne of the Home Loan Bank Board had announced that the Bank Board was considering a reduction in ceiling rates on share accounts and was preparing to negotiate with the Federal Reserve. He asked how the Council members would feel about a move by the Federal Reserve to reduce to 4-3/4 per cent the ceiling rate on consumer CD's.

President Moorhead replied that he would personally be opposed to such a move, since he would prefer to let the marketplace determine the rate. Mr. Stewart commented to the same effect, and Mr. Wilkinson referred to the banks' need for some flexibility. He said that his bank had considered lowering the consumer CD rate a month or six weeks ago. However, the bank anticipated good loan demand, with prospects of an increase in the fall, and decided against making any rate reduction on the basis that the amount of interest expense saved would not make such a move worth while.

Mr. Mayer reported that his bank had reduced the rate to 4-3/4 per cent, that it was followed by one of its competitors, and that in the succeeding month the bank had nevertheless experienced a rather good increase in consumer CD's. The unanswered question, of course, was what increase might have been achieved had the bank remained at 5 per cent. Mr. Wilkinson observed that the trend in CD's would no doubt be affected by general rate expectations. If people concluded that the trend of market rates was downward, they were likely to come to the banks and seek CD's of the longest available maturities.

Governor Daane inquired how it was felt that the Government securities market might react to a lowering of the ceiling rate on consumer CD's; that is, whether people would consider it a forerunner of a further downward rate movement or, on the other hand, a forerunner of the kind of developments that occurred last year.

Such action might be interpreted either as a signal from the Federal Reserve that an escalation of interest rates was expected or as a sign that monetary conditions were going to be easy.

President Moorhead said he was inclined to feel that the market would regard such an action basically as a further effort on the part of the Federal Reserve to drive down rates, and Mr. Wilkinson agreed.

President Moorhead also observed that to a certain extent offering rates on CD's would depend on whether banks believed they could usefully employ the funds. The savings and loans apparently now had more money than they knew how to use; at least that was true in his area. The question, therefore, was why they should not reduce their dividend rates if they did not need the money.

Governor Mitchell agreed that it would appear that a continuation of the current inflow eventually would compel the savings and loans to make some move.

Mr. Larkin expressed the view that the public would interpret an action to lower the ceiling rate as a further attempt on the part of Government officials to make more money available to the mortgage market. He doubted that any more sophisticated interpretation would be placed on such a move, at least by the general public, because there had been so much talk about the mortgage market over an extended period of time.

In response to a question, Mr. Larkin expressed the opinion that the slowness of the real estate market to respond to the greater availability of funds was due in part to a psychological barrier: people had been so exposed to the idea that no funds were available that they were not trying to obtain them. It would take a selling effort by the real estate industry to change that notion, and it could not be changed immediately.

Governor Robertson inquired about the prospective effect on consumer CD's of an increase in the savings deposit ceiling rate to 4-1/2 per cent.

President Moorhead expressed the view that such an increase would not hurt consumer CD's at 5 per cent very much, while Messrs. Mayer and Larkin commented on the potentially serious effect on bank earnings. Mr. Stewart indicated that, although he would want to give the matter more thorough study, he was inclined to feel that banks in Texas might favor such an increase in the savings deposit ceiling.

Governor Mitchell observed that the banking system had about $90 billion in passbook accounts and suggested that if the banks could maintain such a volume at 4 per cent they might not want to change to a higher rate.

Mr. Larkin commented that in recent weeks an upturn in savings accounts had been noted for the first time in a long period. There might be many reasons, including the downward trend and present level of the Treasury bill rate. In his area practically all of the banks were now paying 4 per cent "instant interest" on passbook savings, and cases could be found where money had been shifted from Treasury bills into savings accounts.

Mr. Mayer said he thought there was a tendency to overestimate the degree of sophistication of persons maintaining passbook savings accounts. In his opinion, most such account holders probably did not make close analyses of competitive rates. At times when people felt less secure, they tended to add to their passbook accounts and pay off personal loans. That had been happening recently, in his judgment, and was contributing to the upturn in passbook accounts.

Mr. Fleming noted that a general increase to 4-1/2 per cent on savings deposits would cost the banking system something in the area of $450 million a year, which would represent a considerable impingement on earnings.

Mr. Prochnow commented that earlier this year his bank was losing passbook accounts steadily while consumer CD's were up consistently. Recently, however, the bank's passbook savings had been increasing almost day by day, despite the fact that it was still paying 5 per cent on consumer CD's and gaining there also. He was unable to explain why this change had come about in the past few weeks.

Governor Mitchell commented that statistics compiled by the Chicago Reserve Bank indicated that savings deposits turned over on average about once every two years, with some variation by regions within the District. Nevertheless, despite the turnover rate the aggregate volume remained quite stable. Such accounts appeared to offer a convenient facility for persons less sophisticated in financial management.

Mr. Brinkley said that his bank, which had gone to 5 per cent on consumer CD's the first of this year, had found that only a limited amount of the funds put into those instruments came out of passbook savings accounts. He had substantially the same reaction as Mr. Mayer, that is, that savings accounts were not used for investment purposes as much as for thrift and systematic saving. The investors among his bank's depositors tended to shift their money into the 5 per cent CD's. When that development ran its course, the passbook savings accounts again started moving upward, and the volume was now higher than at the end of last year. In the case of his own bank at least, he did not feel that a 4-1/4 per cent or even a 4-1/2 per cent rate would be likely to generate enough new passbook savings to justify the cost. On the other hand, he doubted that the same principle held true in the case of consumer CD's.

Mr. Knight said he would be opposed to any reduction of the maximum rate on consumer CD's because in his area most of the banks were not in the market for corporate CD's and their growth had to come through savings deposits and consumer CD's. Further, the banks were operating in a very competitive savings and loan market. The savings and loans were paying the top rate and were not only gaining funds rapidly but asking the banks to sell them real estate loans. For the banks, therefore, it would be a serious proposition to widen the spread between rates that could be paid by the banks and the savings and loans.

Governor Robertson said he wanted to make it clear that no place within the Government was there any thought of widening the spread. On the contrary, the thought was that, if anything, the spread should be narrowed to provide a realistic relationship. At the same time, he knew of no one who felt that there should be no spread at all.

President Moorhead expressed the view that the savings and loans could manage without the benefit of a spread. Most of them were large, well-managed institutions, and he doubted whether they needed that protection. It was not clear to him why the banks should have to operate with one arm tied behind them.

Governor Robertson expressed doubt that the savings and loans could stand the pressure of complete rate equality. He agreed with a comment by Mr. Fleming that whenever the spread was more than 1/2 per cent the savings and loans were at a tremendous advantage. However, he did not think they could compete against the banks on an absolutely even basis at this juncture.

Mr. Fleming commented on the loyalty of customers of the savings and loan associations, and President Moorhead referred to the amounts of money spent by the savings and loans on advertising.

C. Do Council members expect any significant changes in bank lending policies in the near future?

The members of the Council do not expect any significant change in bank lending policies in the near future. However, many bankers are selectively more receptive to loan requests than they were a short time ago.

President Moorhead said that the Council had had a good deal of difficulty in framing an answer to this question. There was quite a difference of opinion among the members on the extent to which banks were now making loans of the kinds that they had been turning down in the period of tightness last year. The majority of the members thought that the banks were considerably more receptive to loan requests, on a selective basis, and that there probably would be no significant change in bank lending practices in the near future unless the situation tightened rapidly.

D. What are the present attitudes of banks with respect to the adequacy of their liquidity positions?

Some bankers would like to rebuild further their liquidity positions, which were substantially reduced during the period of stringent credit last summer.

President Moorhead noted that, while bank liquidity positions had improved, the banks were so heavily dependent on corporate CD's that their positions were not regarded as particularly comfortable.

Governor Mitchell observed that outstanding negotiable CD's amounted to about $19 billion, out of total bank deposits of some $370 billion. Passbook accounts had gone through the whole recent episode without much change from the $90 billion level. Accordingly, he found it rather strange that bankers attached so much importance to the corporate CD's, which constituted a relatively small part of the total resources available to the banks.

Mr. Mayer replied that Governor Mitchell had been citing figures for the banking system as a whole, whereas only a relatively few banks issued negotiable CD's. For those banks the CD's represented a considerably larger proportion of their total deposits, and the money was quite volatile.

Mr. Wilkinson commented that a bank was understandingly more concerned when its loan-deposit ratio neared 70 per cent than when it was running in the 55-60 per cent area with the same volume of CD's outstanding.

In response to a question, Mr. Mayer said that most banks had tried to deal with corporate CD's on an arms-length basis. When due, the CD's were paid without question, and they did not figure in as compensating balances. A wall was built between the CD business and the rest of the bank's business.

Governor Mitchell inquired about the possibility of developing some other kind of instrument that would give the banks more reassurance in terms of liquidity, and President Moorhead observed that there would be considerable flexibility in CD's if it were not for the existence of a rate ceiling.

Mr. Mayer then raised the question whether granting flexibility to the banks in terms of CD's over $1 million would have any particular effect on other financial intermediaries. The latter should not be in that kind of business because of the nature of their assets; if they wanted to engage in it, they should become banks.

Governor Sherrill agreed, saying he felt confident that rate flexibility for the banks in terms of CD's over $1 million--perhaps even over $100,000--would have little or no effect on other financial intermediaries.

Governor Robertson inquired whether the Council felt that this was the time to remove interest rate ceilings, and President Moorhead said he would think so, at least for CD's over $100,000. He would personally favor removing all interest rate ceilings, but as a practical matter he supposed that that could not be done out of deference to the savings and loan associations.

Mr. Mayer pointed out that the question of renewing the interest rate control authority provided by the Act of September 21, 1966, would have to be resolved within the next few months, which raised the question whether political considerations would make it feasible to remove rate ceilings at this juncture.

Governor Robertson agreed, adding that the result might be a fixing of ceiling rates by statute. He inquired, however, whether the Council members would feel, purely on economic grounds and disregarding political considerations, that this was a time when the interest rate ceiling authority should be placed on a stand-by basis. Several members of the Council replied in the affirmative, although some reservations were expressed with respect to passbook savings.

There followed discussion of the prospective effects of a removal of the interest rate ceilings. In the course of the discussion Mr. Mayer commented that, for reasons mentioned, the fixing of ceiling rates for smaller deposits probably could not be discontinued. He asked, however, whether the same considerations prevailed with respect to large-denomination CD's.

Governor Maisel inquired whether Mr. Mayer's question implied that even in periods of credit restraint the banks should be allowed to pay as much as they wanted to on large-denomination CD's, and Mr. Mayer replied in the affirmative. Governor Maisel then remarked that this raised a fundamental question in terms of the theory of monetary restraint. For example, if monetary policy dictated no growth in total bank credit over a certain period of time, the question was whether it would be feasible to permit the hundred largest banks to expand their deposits through large-denomination CD's. The share of the other banks would have to decrease, and all of the growth would be concentrated in a small number of money market banks. He doubted whether such a situation would be any more viable than one in which an unstable rate relationship existed between banks and savings and loan associations. The same arguments would be likely to arise within the banking system as were heard last year from the savings and loans.

Mr. Prochnow noted that the smaller banks would not be able to bid for CD's over $1 million in any event, but Governor Maisel suggested that the large banks might be able to sweep accumulations of money market funds into the CD's while, at the same time, the deposits of the smaller banks were decreasing. Mr. Mayer then said that, although he would want to think the matter through more carefully before reaching a conclusion, he felt that Governor Maisel probably was making a real point.

E. What are the present attitudes of banks with respect to the adequacy of their capital positions? With respect to the relative usefulness of (1) increased capital, and (2) realignment of assets, as means of improving capital positions? With respect to the probable market reception of flotations of bank capital?

The members of the Council believe that many bankers are not satisfied with respect to the adequacy of their capital positions.

The Council is of the opinion that bankers would prefer to increase their capital rather than attempt to realign assets as a means of improving capital positions. The borrowing requirements of their customers seriously limit the ability of banks freely to realign their assets, which thus lessens the usefulness of this technique as a method for improving capital positions. The absence currently of new bank capital flotations in the market suggests that bankers are doubtful of the market reception of such issues unless they are priced at a level unacceptable to the banks.

President Moorhead said the Council members were not completely certain what was meant by the Board in referring to realignment of assets. Presumably that would mean lower total loans and more funds held in cash or very liquid assets such as short-term Governments. The Council members felt that it would be difficult to change the asset mix significantly.

Asked how it was felt that bank capital could best be augmented, President Moorhead replied that a distinction must be made between the positions of small and large banks. For large banks the debenture route was quite attractive, perhaps even at current rates. Small banks usually could raise capital only by selling additional stock to their shareholders and through retention of earnings.

> F. What are the views of banks as to the recent expansions of bank credit cards and the methods followed in those expansions? As to the probable future of bank credit cards in the financial picture?

> Bank credit cards are a useful technique in that over a period of time they should tend to channel into banks a growing share of consumer instalment credit now provided by many retail establishments. But the initial promotion of credit cards by some banks has overemphasized the importance of this service in relation to the overall activities of the bank.

> The bank credit card is a logical development toward the retail marketing of bank services in the future. However, it is necessary for banks wishing to offer this service to analyze critically markets, costs, losses, and every aspect of their procedure.

Mr. Mayer said he thought there had been much more conversation about bank credit cards than was warranted by the importance of the subject. Banks had talked too much and had wasted money on advertising. Bank credit cards were not that important in the total scheme of things, and the image of the banking system had not been enhanced.

Mr. Prochnow agreed, saying that the significance of this movement was in his opinion greatly overrated. For various reasons, an unwise promotion and sale of this particular type of service had been precipitated in some areas such as Chicago. Any bank that had in mind going into the credit card business should analyze the situation with great care, for there were many pitfalls. In any event the significance of the credit card business to the banks tended to be vastly overrated, particularly in terms of the relationship to total bank earnings.

Governor Sherrill inquired whether these remarks were addressed to the relatively short run or to a period of, say, 15 years ahead, and Mr. Mayer replied that he was not certain about the long run. He hoped that the expansion of bank credit card systems would come to some good, but that was not a sure bet by any means. Mr. Prochnow observed that unless organizations such as Sears and Montgomery Ward, which conducted their own profitable operations, came into the bank credit card picture the volume of available business would appear to be limited even over the longer run.

Governor Maisel inquired whether the movement could develop more toward the selling of an accounting than a loan service, and Mr. Mayer replied that participation in a bank credit card system permitted small merchants to operate on a more equal footing with large merchandisers having sophisticated credit departments. To that extent the bank credit card systems might be said to provide a social service. However, there was the question whether such a social service should be rendered at the expense of bank shareholders.

Mr. Simmen said that his bank had given up its charge-credit plan about five years ago because it could not work up a sufficient volume through the large department stores. Also, it found that the small tradesman was billing his good customers and discounting the accounts of his less credit-worthy customers.

Mr. Brinkley noted that the Federal Reserve had announced a study of bank credit card plans. He inquired whether the initiation of the study reflected any particular concern, or to put it another way, what areas were being studied and why. Governor Robertson replied that the study had been undertaken simply because the Board felt that it should know more about the problem.

President Moorhead expressed the view that there were not too many markets throughout the country large enough to support a credit card system. In his area, for example, if certain large retailers and others were not brought into the plan, participation in a credit card system would come down to units such as the small hardware merchants. A large volume of business could hardly be worked up on that basis. Banks should not rush into credit card systems without exploring the market potential, and in most cases they might find that potential surprisingly small.

Governor Daane withdrew from the meeting at this point.

3. Balance of payments.

A. Do Council members expect foreign demands for term loans, short-term loans, and acceptance credits from U.S. banks to change significantly in the months ahead?

The Council members expect that foreign demands for term loans may increase because of the substantial need for longer term credit. The demand for short-term loans and acceptance credits from U.S. banks will remain about the same in the months ahead because of the somewhat slower pace of economic activity that marks the economies of many of the major trading nations of the world.

B. Would the Council expect U.S. bank indebtedness to the Euro-dollar market to increase, decline, or remain about unchanged in the next few months?

The Council expects that the volume of U.S. bank indebtedness to the Euro-dollar market will be largely determined by the availability of funds in our markets and the competitiveness of interest rates here and abroad.

President Moorhead said the Council was aware that its statement on the second question might not seem particularly responsive. However, it felt that the volume of U.S. bank indebtedness to the Euro-dollar market was a day-to-day proposition, with the trend largely dependent on the relationship of interest rates here and abroad.

Governor Maisel commented that this was a very important answer, and President Moorhead said that right at the moment the rate relationship was not particularly attractive. Therefore, the volume of indebtedness was trending downward, but the situation could change quickly.

Mr. Fleming noted that the availability of funds in U.S. markets was also a factor, and President Moorhead explained that some banks, in anticipation of a pinch next fall, were taking steps to assure themselves of funds even though the rates might not be especially attractive. Mr. Prochnow said that at least one large bank was moving actively in that direction. It foresaw a serious shortage of funds and was willing to pay a slight premium to be sure of having funds available that would not come due until next year.

In response to a question, Mr. Prochnow said that banks would not pay as much as 1/2 per cent above the CD rate, although they might be willing to pay 1/4 per cent more. It was, of course, necessary to make a computation that took into account the absence of insurance and reserve requirements against indebtedness to the Euro-dollar market.

4. What are the Council's views on monetary and credit policy under current circumstances?

The Council is aware of the difficult dilemma facing the Board as it attempts to formulate an appropriate credit policy in view of the uncertainty of the outlook of business and the following conflicting objectives:

(1) providing the reserves required to insure the financing of the Federal budget deficit, while at the same time

(2) combating the inflationary pressures a large deficit may precipitate.

In general, the Council reaffirms its views on this subject as expressed as follows in the Confidential Memorandum to the Board at the February meeting.

> The Council in general approves of the easing that characterizes current monetary and credit policy. Moreover, the Council is hopeful of favorable consideration by the Congress of a more restrictive fiscal policy--a reduction in nondefense expenditures, or failing that, an increase in taxes. This will permit a more balanced mix of fiscal and monetary policy rather than the undue reliance on credit restriction which marked much of 1966.
>
> Because of the balance of payments and inflationary problems, any further significant easing of monetary policy should be contingent upon a more balanced mix of fiscal and monetary policy or a further slowing in over-all business activity.

Governor Maisel said it was not clear what the Council meant by an easing of monetary and credit policy. For example, if one assumed a 6 per cent growth rate for the economy, the financing of the Federal budget deficit might require an additional 2 per cent rate of growth of reserves. Even so, however, short-term interest rates might rise. The question was whether that would represent an easing of monetary and credit policy or not.

President Moorhead replied that he could foresee a situation where more reserves would have to be injected into the banking system for reasons such as Governor Maisel had mentioned, yet free reserves might be maintained at about an even level.

Governor Mitchell referred back to the first topic on today's agenda and said he understood, in light of the Council's response on that topic, that it would favor more or less a continuation of current monetary and credit policy for the next two quarters, although sufficient reserves should be provided to finance the budget deficit.

The Council appeared to be proposing an increase in taxes in the absence of a curtailment of nondefense expenditures, and he asked whether that implied an increase in taxes in the fall.

President Moorhead said the Council believed that in the absence of an increase in taxes or a reduction in nondefense expenditures the situation could again revert to a large measure of dependence on monetary policy.

Governor Maisel noted that the Council also appeared to be saying that if an increase in taxes was assured effective at the beginning of next year there need not be so much worry from the standpoint of monetary policy. President Moorhead replied that the Council was looking forward to a fairly moderate business upturn in the second half of this year but believed that an overheating of the economy might come later. If so, a tax increase effective at the beginning of next year would be timed about right. However, if Congress adjourned without having enacted a tax increase, it would be well into 1968 before any such action could be taken. The war in Vietnam had to be financed, and in that the Council saw strong inflationary implications. It would not want to see full dependence placed on monetary policy.

Governor Mitchell commented that a 4 per cent over-all growth of GNP would hardly suggest the kind of loan demand apparently foreseen by the Council, and President Moorhead agreed. As had been brought out earlier, however, the trend of bank growth was consistently smaller than the growth of the economy as a whole. Mr. Fleming said he foresaw a heavy loan demand superimposed on a high base. For that reason, many people were trying to get as liquid as possible in preparation for what might lie ahead.

Mr. Fleming also commented that the banks would feel better if they had more assurance in terms of access to the discount window.

Governor Mitchell replied that most of the studies undertaken in connection with the current reappraisal of the discount mechanism were in hand or nearing completion and that by summer the documentation should be about complete. He could not predict, of course, what actions might be taken. However, the studies tended to suggest that some innovations in discount window administration might be in order.

Mr. Fleming said that if the banks could be informed a little more definitively in terms of the prospects for discount policy, that should have quite an effect on their plans.

Governor Maisel pointed out, however, that if it were decided, as a monetary policy decision, that the growth of bank credit should be held to a certain rate, use of the discount facility would have to be reconciled with the total picture. Any design of the discount window mechanism would have to take that factor into account. The discount window could not be opened on an unlimited basis while at the same time there was a basic decision to hold down the growth of credit.

Governor Mitchell inquired whether bank attitudes would be changed if in some way the Administration could give assurance that restraint in the fall of this year or in 1968 would come about, at least in part, through fiscal measures.

President Moorhead said he thought that would have some effect on the planning of the banks, but Mr. Fleming expressed the view that it would not have much relevance to the liquidity problem. Governor Mitchell observed that it might suggest that there would not be a sufficiently buoyant economy to justify higher interest rates. Mr. Fleming noted that escalation of the war effort made it difficult to predict economic trends, and Governor Mitchell replied that nevertheless everyone had to make some predictions. The Council was, in effect, expressing its apprehensiveness about a return to credit restraint in the fall. Therefore, the banks wanted more liquidity to be ready to deal with the situation if it came. Mr. Fleming noted that, although the timing could not be pinpointed, he did feel that a situation such as described by Governor Mitchell was apt to occur within the next 12 months.

President Moorhead commented that if it seemed clear that restraint was not going to be exercised through fiscal measures, that would certainly have a bearing on one's planning.

Mr. Brinkley remarked that at one time a bank could chart a predictable pattern of loans and deposits. Now, however, there were no such patterns, and that tended to keep the banks uncertain.

Mr. Fleming inquired whether it appeared that the "eligible paper" bill recommended by the Board might be passed by the Congress, and Governor Mitchell said he was inclined to feel that it would. Mr. Fleming noted that that would be helpful.

Governor Robertson brought out that in today's discussion no indication of bearish sentiment regarding business prospects had been heard. Apparently, therefore, none of the Council members considered it likely that the economy would not move upward.

President Moorhead said he thought that was correct. When a war effort was superimposed on a vigorous domestic economy, it was hard to see that the economy could move in any direction except upward. Mr. Fleming observed, however, that there was some bearishness in terms of the prospects for profits.

Delegation of Board functions. In reply to a question raised by a member of the Council, it was stated that after careful study the Board had compiled a tentative list of functions that it felt might appropriately be delegated either to officers of the Board's staff or to the Federal Reserve Banks, together with a list of functions that it believed warranted continued consideration by the Board. Certain implementing procedures, as required by law, had also been developed. The list of functions proposed to be delegated, which was substantial, had now been submitted to the Reserve Banks for comment, and it was anticipated that in the relatively near future the Board would be in a position to take action.

Balance of payments. In response to a question regarding prospects for the U.S. balance of payments, Governor Robertson said it appeared that the deficit figures were running somewhat higher this year, although not to such an extent as to create undue alarm. For various reasons, the trend was not unexpected. The bank portion of the voluntary foreign credit restraint program seemed to be moving along well, and some improvement was indicated in the area of corporate direct investments. However, there had not been as favorable a trend in the trade balance as would have been desired.

Asked whether it seemed likely that the Congress would pass legislation to remove the 25 per cent gold cover against Federal Reserve notes, Governor Robertson said that was anyone's guess. He thought personally that such legislation might be enacted. In his opinion, the attitude throughout the country toward the question of the gold cover was quite different today from a few years ago.

Asked whether there was any alternative to such legislation, Governor Robertson said that on the basis of the best estimates it might be possible to get through until about 1969, but that would be running too close for comfort. The question with respect to enactment of legislation to eliminate the gold cover seemed only to be one of timing.

It was agreed that the next meeting of the Federal Advisory Council would be held on September 18-19, 1967.

The meeting then adjourned.

Secretary